

<b>Eshman Holdings Ltd. v United States Philips Corp.</b>
2005 NY Slip Op 30585(U)
April 15, 2005
Supreme Court, New York County
Docket Number: 102785/04
Judge: James A. Yates
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### Background

On February 25, 2004, Eshman commenced the present proceeding, pursuant to CPLR section 5239, to enjoin Philips, a creditor, from enforcing a money judgment, entered November 19, 2003 in Supreme Court, Westchester County, in the amount of \$868,234.23 against Wings Digital Corporation, an alleged pirate replicator of compact discs. Eshman argued it has a perfected security interest in Wings' property which precedes in time the judgment. Philips countered that the transactions and loan agreements between Eshman and Wings Digital were in fraud of creditors.

On March 11, 2005, a hearing was held to determine the legitimacy of the security interest held by Eshman. The burden of proof rest with Eshman to establish by *prima facie* showing that a valid security agreement between itself and Wings Digital was executed and perfected prior to the judgment. The burden then shifted to Philips to show that the security interest was fraudulently obtained. See *Direct Merchants Credit Card Bank v Greenpoint Bank*, 2003 NY Slip Op 50784 [U] [Nassau Dist Ct, 1<sup>st</sup> Dist 2003]; cf. *MFS/Sun Life Trust-High Yield Series v Van Dusen Airport Servs. Co.*, 910 F Supp 913 [US Dist Ct, SD NY 1995]. Maninder Sethi, the founder and sole owner of Wings Digital, and his brother, Jitender Sethi, testified at the hearing, explaining the relationships of the individuals and companies involved in the transactions in question.

### Findings of Facts

The Sethi family is comprised of Loveleen Sethi and her two sons, Maninder Sethi, and Jitender Sethi. The family owns and are involved in a number of business ventures jointly and as individuals. There are ten known companies owned by the three members of the Sethi family which were described in the hearing. The Sethi family businesses apparently share resources and all three family members share responsibilities for certain transactional purposes. The companies pertinent to this matter include: 1) Wings Manufacturing, an importer and distributor of sportswear located in Hicksville, NY, established in 1979, and owned by M. Sethi; 2) Eshman Holdings, Ltd., an off-shore company, engaged in coffee trading, incorporated and with offices

in Nairobi, Kenya and owned by J. Sethi; 3) Jazzman's Sportswear Corporation, an importer and distributor of sportswear located in New York, and co-owned by M. Sethi and J. Sethi ; 4) Leena Enterprises, located in Bombay, India, engaged in exporting sportswear garments, owned by Leena Sethi and managed by J. Sethi. Hearing Tr. (Tr.), dated March 11, 2005, at 111.

In 1995 M. Sethi created Wings Digital Corp. (Wings Digital) to engage in the business of manufacturing and selling compact discs and other audio equipment. Tr. 16. He financed the start-up costs with \$2,500,000 of his own and his wife's money. However, M.Sethi needed more money to purchase equipment from Multi Media Masters and Machinery (Multi Media). He sought additional financing from National Westminster Bank. To secure a line of credit from the bank in favor of Multi Media, he claimed an asset of \$1,650,000 - certain "accounts receivable" owed to Leena Ent. which his mother assigned to Wings Digital. Not presented to the bank was the fact that mother and son considered the assignment to be a loan. It is this assignment/loan which forms the basis for the later claim by Eshman of a prior security interest in Wings Digital.

Also not explained to the bank was the underlying basis of the assigned accounts receivable. Allegedly, the two sons - acting through Wings Manufacturing (owned by M.Sethi) and Jazzman (owned by J.Sethi) - owed Leena Ent. (owned by their mother) \$1.65 million for "sampling and buying services." There is no evidence supporting the reality of this alleged account receivable and there is no description or documentation of the services provided by Leena Ent. to warrant the account. There is no record of any apportionment of the loan responsibility between the two brothers.

In sum, M. Sethi was able to gain a \$1.65 million line of credit by claiming as an asset money owed by him and his brother to his mother which she "lent" back to him. Even more astounding, it appears to the Court that the assigned account receivable itself was for the provision of unspecified "services" from the mother to her sons.

The initial loan agreement between Wings Digital and Leena Ent. was for a period of 5 years, with interest at 8.25%. A Letter of Agreement was signed on August 15, 1995 (the Loan Agreement) setting forth the terms of the loan. Respondent's Wings Ex. 3. On August 15, 1995 Wings Digital signed a note in

favor of Leena Ent. in the amount of \$1,258,518.06. The note provided for interest at 8.25% chargeable from January 1, 1997 and maturing in five years on August 15, 2000. Wings Ex. 5. Pursuant to the terms of the Loan Agreement, on or about July 31, 1996. Wings Digital signed another note in favor of Leena Ent. in the amount of \$390,351.19. This note was also due on August 15, 2000. Wings Ex. 4. On or about March 20, 1998, Wings Digital borrowed an additional \$250,000 from Leena Ent. with interest at 8.25%, to mature in five years. Wings Ex. 6.

Sometime prior to January 4, 2000, Mrs. Sethi allegedly asked her son J. Sethi to help her collect the loan she had made to Wings Digital since she was having difficulty collecting the money owed by her other son, and the debt was allegedly creating a strain on family relations. Tr. 99-101, 116, 119.

Apparently Mrs. Sethi had no difficulty asking J. Sethi to collect on the loan to M. Sethi despite the fact that the obligation, at its inception had been the joint obligation for the "account receivable" owed by J. Sethi and M. Sethi. In effect, J. Sethi had been relieved of his obligation to pay Leena Ent. for the "services" included in the account receivable, but then was asked to collect on that same obligation from his brother on behalf of his mother. An intermediary, Mr. Avtar Bassan, a director of Eshman Holdings, assisted in arranging for the assignment of the Loan Agreement and related loan obligations (the Notes) from Leena Ent. to Eshman. An Assignment Agreement was signed on January 4, 2000 by Leena Ent. and Eshman (the Assignment). Wings Ex. 11. The Assignment included all of the obligations of Wings Digital to Leena: the Loan Agreement dated August 15, 1995; the Note dated August 15, 1995 in the amount of \$1,258,518.06; the Note dated July 31, 1996 in the amount of \$390,351.19; and the Note dated March 20, 1998 in the amount of \$250,000.00. Wings Ex. 11. On August 15, 2000, Wings failed to make payment of the notes pursuant to the Loan Agreement.

No consideration was paid by Eshman in return for the alleged assignment. Tr. 100-102. In fact, the loan obligation was not transferred from Leena Ent. to Eshman. Mrs. Sethi merely asked Eshman to collect upon the loan. J. Sethi claims to have paid over monies received from Wings to Leena Ent.

Eshman and Wings Digital restructured the loans covered by the Assignment and granted J. Sethi's company, Eshman, a security interest in the assets of Wings Digital. Wings Ex. 12; Tr. 119.

The Restructuring Agreement provided for the following: an extension of credit for the outstanding notes for two years; incorporation of the interest due on the Notes into the principal for a new sum due of \$2,348,709.08; a new note for \$2,348,709.08, maturing on August 15, 2002, with an increase in the interest rate from 8.25% to 9.5%; a security interest in Wings Digital's assets as security for the Restructured Note; and a personal guaranty of Maninder Sethi for the obligations of Wings Digital to Eshman. Wings Digital signed a Promissory Note in favor of Eshman dated August 15, 2000 for \$2,348,709.08, maturing on August 15, 2002, with interest at 9.5% (the Restructured Note). Interest was to be paid on February 15, 2001, August 15, 2001 and February 15, 2002, and the balance of principal and interest was due on August 15, 2002.

The two parties also signed UCC-1 Financing Statements. Pet. Ex. 3, 4. The security interest was allegedly perfected by due filing of the Financing Statements in Albany and Nassau County on December 15, 2000 and December 18, 2000 respectively, pursuant to the Uniform Commercial Code. Pet. Ex. 3, 4.

Wings Digital did not make the required payments on the note signed on August 15, 2000. Tr. 129. Wings Digital and Eshman signed an Amended and Restated Promissory Note dated August 15, 2002 extending the loan for an additional year. Wings Ex. 17. At this time, despite the missed deadlines and almost complete lack of payments over the first seven years of the loan, Eshman lowered the interest rate from 9.5 % to 8.5%. The Amended and Restated Promissory Note has not been fully paid in accordance with its terms and Wings Digital is in default of its obligations under the Amended and Restated Promissory Note dated August 15, 2002. Tr. 129-130. Eshman has not taken any steps to enforce the Promissory Note from Wings Digital.

Notably, Wings Digital first began to make payments to Eshman (three payments totaling \$117,000) only recently, when Philips sought to collect from Wings Digital. Wings Digital's few remaining identifiable assets were transferred from one brother to the other.

Philips and Wings Digital entered into a CD Disc License Agreement on March 1, 1998. Wings Digital breached the agreement with Philips by failing to make quarterly royalty reports and payments. On November 19, 2003, the Honorable Kenneth W. Rudolph of the Supreme Court of New York, County of Westchester, granted

Philips' motion for summary judgment in a breach of contract action and awarded damages in the amount of \$868, 234.23. Philips sought to enforce the judgement but was unable to locate any assets of Wings Digital in the State of New York. On January 22, 2004, after finding assets in Bergen County, New Jersey, Philips was granted a temporary restraining order to prevent disbursement of the funds in the New Jersey account. On February 2, 2004, Eshman filed a motion to intervene on the restraining order and claimed that it was entitled to the funds due to its senior security interest. On February 12, 2004, Philips served information subpoenas and restraining notices on Wings Digital and Fleet Bank. On February 25, 2004, Eshman Holdings served Philips with an Order to Show Cause and supporting papers requesting that Philips be permanently enjoined from executing its judgement against any property of Wings Digital subject to the Security Agreement. Eshman also moved to have the restraining notices and information subpoenas vacated.

#### Findings of Law

Eshman's security interest is not superior to that of Philips. The UCC filing was for an assignment made solely for collection, which is not authorized by the UCC. In addition, the Court finds, by clear and convincing evidence, that the entire series of transactions between family members was nothing more than a fraudulent attempt to artificially inflate the value of the companies owned by them and to prevent collection of debts they incurred.

In evaluating whether fraudulent intent exists with regard to a conveyance, courts consider "badges of fraud" or circumstances so commonly associated with fraudulent transfers that they give rise to an inference of intent. Badges of fraud include close relationship among the parties, inadequacy of consideration, retention or control of property by transferor after the conveyance and failure to act on a longstanding debt. See *Insilco Corp. v Star Services*, 2 AD3d 343 [1<sup>st</sup> Dept 2003].

Each of the companies involved in the Eshman lien are owned by members of the Sethi family. The transactions between Eshman Holdings, Wings Digital, and Leena Enterprises were permeated with fraud. Among the circumstances surrounding the assignment of loans is the lack of valid consideration. "Intra - family transfers made without any signs of tangible consideration are

considered to be presumptively fraudulent." *Morgenthau v A.J. Travis Ltd.*, 184 Misc 2d 835 [Sup Ct, NY County 2000]. Nothing in the record shows that any hard currency or any other form of legitimate consideration ever passed between the companies. Rather these three family members, who stand to benefit from the transfers, shuffled agreements and empty promises back and forth between each other in an attempt to cover-up questionable transactions. The rare payments that were made by Wings Digital to Eshman upon the supposed loan came only in the end, as a way of transferring assets from one brother to the other in avoidance of the obligations to Philips.

If one accepts as true - which the Court does not - the claim that Jatinder (as Jazzman Sportswear) and Maninder (as Wings Manufacturing) actually owed money to Leena Enterprises (his mother) for services rendered in 1993 and 1994, the ensuing transactions still make no sense. If one takes a larger view of the various transactions, Jatinder is attempting to convert a debt into an asset at no cost to himself and without any consideration passing between the parties.

According to Jatinder, he (along with his brother) owed an unspecified portion (if not all) of the \$1.65 million "account receivable" to Leena Ent. in 1995. His current claim is that Mrs. Sethi lent that debt to Maninder (one of the obligors), freed the other obligor (Jatinder) and then assigned it back to Jatinder for collection, without anything of value changing hands. He would have the Court believe that Mrs. Sethi absolved Wings Manufacturing, Jazzman, and himself (Jazzman) of all responsibility for the debt to Leena Ent. - while passing it on to Wings Digital for no identifiable commercial reason. He would have the Court believe, further, that Leena Ent. assigned the debt back to him (the original debtor) for collection but without any specific understanding of whether the debt is owed to Jatinder, Eshman, Leena Enterprises or his mother.

Thus, the supposed debt was passed around, like a pea under a walnut shell, with creditors (including National Westminster Bank, Multi Media and Philips) left to guess wherein it rested. All transactions were completed without any currency changing hands. There are no bank statements in the record to show that these alleged transfers actually took place, they are only evidenced by "agreements".

Specifically, the Court finds as follows:

1. The initial debt allegedly owed by Wings Manufacturing and Jazzman and claimed as an account receivable for services rendered by Leena Ent. in 1993-94 was a non-existent fiction.
2. The purported assignment to Wings Digital of monies owed by Maninder and Jatinder to their mother was nothing more than a pretext to artificially create an asset (consisting of nothing other than Maninder's own obligation) in the new company, Wings Digital, for the purpose of obtaining a line of credit.
3. The filing was never intended to evidence a real debt; it was nothing more than an attempt to keep assets within the family while defeating legitimate credit obligations.
4. No consideration was paid to relieve Jatinder (Jazzman) of the debt to his mother (Leena Ent.), assuming the debt ever existed.
5. No consideration was paid in return for the assignment to Jatinder (Eshman) of the debt supposedly owed to Leena Ent.
6. The assignment to Eshman was solely for collection on Leena Ent's behalf.

This Court finds this intricate paper trail was created as a way of trying to escape any liability to any potential creditors including Philips by shuffling paper obligations between the family members. There is clear and convincing evidence that the assignments were made to hinder and defraud the creditors of Wings Digital.

Additionally, Eshman failed to demonstrate it has a valid prior perfected security interest under the terms of Article 9 of the Uniform Commercial Code. The transfer was done as an assignment for collection. Assignments or promissory notes which are for the purpose of collection only are inapplicable to UCC Article 9. See UCC § 9-109 [d] [5].<sup>2</sup> Eshman's filing is inadequate to perfect its claim. Therefore, the agreement between Eshman and Wings Digital is unenforceable under the laws

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<sup>2</sup> McKinney's Uniform Commercial Code § 9-109 states, in part:

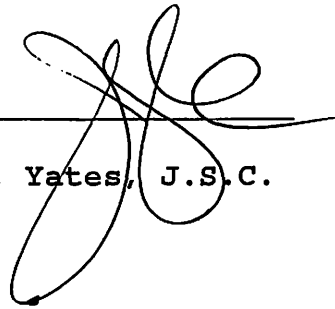
(d) Inapplicability of article. This article does not apply to:  
 (5) an assignment of accounts, chattel paper, payment intangibles, or promissory notes which is for the purpose of collection only \* \* \*.

of New York State.

Accordingly, because Eshman does not have a perfected security interest in Wings Digital, its UCC filing is void and Petitioner's motion to permanently stay Philips' enforcement of the Westchester County court judgment is denied. This constitutes the Decision and Order of the Court.

Dated: April 15, 2005

ENTER:



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James A. Yates, J.S.C.

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